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April 11, 2011

Investment Policy Sub-Committee
California Public Employees' Retirement System
Lincoln Plaza, 400 P Street
Sacramento, CA 95814

Re: Statement of Investment Policy for Real Assets – Real Estate Program

Dear Members of the Investment Policy Sub-Committee:

In our capacity as Real Estate Consultant to the Board for Real Estate, Pension Consulting Alliance, Inc. (PCA) has reviewed the proposed modifications to the above referenced Real Asset Policy for the Real Estate Program. These modifications are primarily driven by the adoption of a new strategic plan by the Investment Committee on February 14, 2011.

The new real estate strategic plan will focus investment on stabilized, cash-oriented and leased properties. PCA believes the proposed real estate policy is aligned with objectives of the strategic plan adopted by the Investment Committee. Any breaches of policy will continue to be reported to the Investment Committee as well as a plan to bring any breaches into compliance. It is important to note that certain aspects and metrics of the current real estate portfolio will not be in compliance today with the adoption of the proposed modifications, including the 75% minimum for core properties. Given the current complexion of the real estate program, staff has indicated it may take five or more years to bring these elements into compliance without jeopardizing the current holdings in the real estate program.

The prior policy document, which was adopted in 2009, consolidated and replaced nearly two dozen policies loosely organized by investment type and structure. PCA notes that some of those are still included in the proposed modifications, including: For Sale Residential and Land Development, California Urban Real Estate and Public Real Estate Equity Securities. We also note that Staff is rolling the previously stand-alone Agricultural Land Real Estate Program policy into the proposed policy document. We believe that these policies should be scrutinized and evaluated in order to fold any of the necessary and valid considerations into the overall policy going forward, consistent with the revised role of real estate within CalPERS' overall investment portfolio.

Additionally, these proposed modifications are the first parts of the strategic plan implementation. There will also be required modifications to the Delegation Resolution and Staff Internal Procedures Manual. The interdependency of these documents with the strategic plan should lead to a more rigorous focus on risk management and oversight functions within the real estate portfolio.

Based on our review of the current proposed modifications and other supporting documentation, PCA concurs with the proposed modifications to the Statement of Investment Policy for Real Assets – Real Estate Program. Further, PCA believes the proposed policy is not too constrictive or flexible and provides enough balance to give Staff the flexibility to execute in a changing marketplace without diluting the objectives of the real estate program.